

A BETTER WAY TO PRICE

by Guy Lyman

How multifamily redeveloper Berkshire uses revenue management to help determine pricing of renovated units, and more.

“We’re primarily in the business of creating value for our owners and investors,” says Dean Holmes, a divisional vice president with the Berkshire Property Advisors. “We redevelop and reposition multifamily properties all over the U.S.”

This focus on renovation adds an extra layer of complexity for Berkshire when addressing a considerable challenge for all property managers in the industry: where to set rents.

“When we’re evaluating a renovation, we consider the current achievable rent for the units at the property as they are today, what rents are achievable through renovation, and what degree of improvement we should undertake that will make sense in light of the potential return,” explains Holmes.

“In a highly stable market, it’s not a difficult task. The premium you are achieving is easy to monitor by closely tracking rent levels in the market. But in a more volatile market, like we’re in today, it’s much more complicated. Market demand is down, rent levels are constantly changing and with people looking to spend less on rent, they’ll take a less appealing alternative. Executing our strategy in this volatile economy requires a much more sophisticated approach to pricing to ensure that we are consistently getting an acceptable return on our redevelopment capital.”

PEER PRESSURE

Berkshire actually began looking at revenue management over three years ago, during a strong market. “We were seeing so much revenue growth around us in good markets, and wondered if we were maximizing potential profit,” says Holmes. “For example, we had some managers who were too protective of occupancy and therefore hesitant to raise rents when they should. Pricing in high growth markets can be fairly subjective unless you have a scientific way to determine it.”

With revenue management, a software application weighs more variables than any human can, in order to set an ideal rent price. To present a price to a prospect, the system considers available inventory over the next few months; the latest rents achieved for new leases and renewals; renewal conversion rates; local market competition; unit level amenities; the requested term in light of lease expiration statistics and turn costs; move in date in light of vacancy cost; and more. The result is accurate pricing for each

type of unit each day, systematically calculated to be the best possible price in the context of a prospect's alternatives.

In the summer of 2008, Berkshire decided to embark upon revenue management for an initial group of 15 properties, choosing YieldStar's Price Optimizer solution. By this time, the multifamily market had become volatile, and pricing renovated units was particularly challenging.

"One of the smartest things we did was to bring in a guy who could really focus on revenue management," says Holmes, referring to Ken Catmull, who serves as Revenue Manager for Berkshire. "He had operations experience and credibility all the way down to the site level. So he could function as a champion for the technology, and could explain the benefits and get people fired up about it."

A NEW PRICING PARADIGM

"There's an evolution that takes place when you roll out revenue management," says Ken Catmull. "At first, users are uncomfortable with the tempo at which rent changes are made, and they're not clear as to why. But before long, they figure it out, and begin trying to predict what pricing the system will produce and even try to outperform it. Finally, they develop a comfort level and believe that the system is reliable and predictable, that the recommendations are rational, and they become effective users."

"It's important to educate people as to how YieldStar arrives at its recommendations," he adds. "And managers need to understand that it's just a tool – they still have the ultimate authority and are expected to apply their expertise in pricing rents. They are encouraged to review the recommendations, and to question them if they see something unusual."

"At the same time, though, managers shouldn't question pricing from YieldStar without a clear reason. Revenue management has proven to work best when you give it your trust."

"Some of the differences are merely perception," Catmull continues. "For example, you're moving from a practice of giving concessions to charging net effective rent. So even though pricing a unit at \$1,000 and giving a \$200 concession is no different in reality than pricing it at \$800, the perceived drop in the rent is scary to some, until they get used to it."

Catmull reports that the leasing agents love the multitude of carefully-calculated pricing options the system allows them to offers prospects, based on lease term, move-in date and amenities. They also enjoy being freed from the "let's make a deal" aspect of their jobs. These sentiments are widely shared amongst leasing agents at companies that have adopted revenue management.

PRICING REHABS

Since Berkshire's primary business objective is to add asset value through renovation, a core function of YieldStar is to help the company accurately price units post-rehab. "This is where revenue management can really help due to the complexity of getting the pricing right," says Catmull. "It's not enough to just look at the local market comps for the upgraded units and slap a premium on. You have your unit inventory to consider, the forecast for the coming months, all sorts of variables that are too much for a

human to calculate into the pricing. Our strategy has been to amenitize the rehab premium value and allow Yieldstar to manage the base market rent based on supply and demand. The objectivity of the computer is a great asset. It *only* thinks about revenue.”

ROLLING OUT REVENUE MANAGEMENT COMPANY-WIDE

The implementation of Price Optimizer began in July of 2008. Berkshire first tested the system in a set of assets chosen for their diversity of markets and in order to include all corporate level management. After only a few short months, they expanded their use to a second group of assets primarily located in struggling Florida markets. “YieldStar was a huge help in establishing the most profitable pricing for these assets,” says Catmull. By November of 2008, 25 of the company’s 94 properties were using the system. The rest are being implemented over the next few months.

“When you implement revenue management, it’s always interesting for managers to watch the effects, as the system works out the ideal balance of rent and occupancy to achieve maximum profit,” says Catmull. “You have properties where occupancy goes up and rent goes down, and vice versa, in all sorts of degrees. Sometimes it’s quite unexpected. And of course, you get people saying things like ‘we can’t ask that much!’ –but the system knows what it’s doing, and they come to see this in short order through results.

REALIZING A PREMIUM

“Managers are asking me how quickly they can get on the program,” says Holmes. “We’re geographically dispersed around the country, and just about every property we have in our portfolio has at least one competitor on Price Optimizer. What’s impressing us is how well our competitors on Price Optimizer are performing, and likewise, managers at Berkshire properties using Price Optimizer feel good about how they’re measuring up to the competition,” he continues. “There’s a certain confidence they get when they know they have pricing nailed. And there’s another interesting result: you can pretty quickly identify properties that have not been priced correctly in the past, once you see the adjustments the system makes.”

“You can also better pinpoint where your problems lie,” adds Catmull. “If you know you have the pricing right, and a property is under-performing, then you turn your attention to things like how the leasing team is executing, whether the product looks right, and whether it’s being sold the right way.”

Dean Holmes concludes: “We have generally seen much more stability in properties using YieldStar in terms of rent level, occupancy and revenue than in the rest of the portfolio. YieldStar has given me an appreciation for all the dynamics that should be considered when setting prices. I’m a convert.”

Guy Lyman is a Dallas-based freelance writer who specializes in the multifamily industry.



Berkshire Property Advisors, L.L.C., is one of the nation's most experienced multifamily real estate investors and managers. It is responsible for the property management of its multifamily portfolio which includes Berkshire Income Realty, Inc, an \$800 million multifamily REIT and the Berkshire Multifamily Value Fund, L.P. which is expected to be a \$1.2 billion multifamily portfolio when fully invested.

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